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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF GOLD CANYON SEWER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02519A-06-0015 **LEGAL BRIEF REGARDING PRIOR COMPANY STATEMENTS**

Gold Canyon Sewer Company ("GCSC" or "Company") provides the following legal brief in response to Commissioner Mayes' August 9, 2006 letter. Commissioner Mayes asked the parties to address the circumstances surrounding prior statements attributed to GCSC by customers regarding alleged "promises" not to raise rates. *See* August 9, 2006 letter.

I. SUMMARY STATEMENT OF THE ISSUES.

The focus of this brief is simple—in her August 9 letter, Commissioner Mayes sought input from the parties regarding customer objections to the Company's rate request based on promises allegedly made to customers (by former GCSC employee Trevor Hill) in 2002-2003 that GCSC would not raise rates as a result of its recent renovation and expansion of the wastewater treatment plant. The question then becomes what legal effect such statements have on GCSC and this pending rate case.

The short answer is none. Under Arizona law, those comments and statements attributed to GCSC have no legal effect on the pending rate case for several equally compelling reasons. First, GCSC did not make any legally binding promises that it would not increase sewer rates as a result of Company investments for plant renovation and expansion. The various comments attributed to Mr. Hill revolve around statements in 2002-2003 relating to the Company's renovation plan. Mr. Hill explained to customers that GCSC did not intend to seek an immediate rate increase for the renovation costs. Rather, GCSC intended to upgrade the plant and resolve the long-standing noise and odor problems before pursuing any rate increases.

In turn, GCSC funded the $11.2 million expansion project with "paid-in-capital" provided by Algonquin Water Resources America ("Algonquin") and hook-up fees for new connections. As evidenced by the Arizona Corporation Commission ("ACC") and ADEQ inspections, the renovation project rectified the odor and noise problems with the plant. The renovations became operational in October 2005 and GCSC then filed its rate case in January 2006. In undertaking the renovations, GCSC did not agree to forgo its right to seek a just and reasonable rate of return on such investments.

Instead, Mr. Hill provided a written handout to customers in 2002-2003, in which GCSC "committed to provide the upgrade through a combination of paid-in-capital and new development hook-ups." *See* Gold Canyon Sewer Company Plant Upgrade Questions and Answers (attached as Exhibit A). By telling customers that the project would be financed with "paid-in-capital", GCSC clearly expressed an intent to recover a return on its capital investment through utility rates.

Second, the statements attributed to Mr. Hill are not legally binding on GCSC. Those statements were not made as part of a binding legal contract with customers. Mr. Hill advised customers of the Company's future business plans, and he expressed the Company's commitment to fund the renovation project and resolve customer complaints

regarding noise and odor problems *before* seeking a rate increase. GCSC has fulfilled that commitment to its customers.

Third, as a matter of law, the comments attributable to GCSC and Mr. Hill are not relevant to the Commission's consideration of the pending rate case. If GCSC paid for property that is used and useful in proving service to ratepayers, GCSC is entitled to earn a just and reasonable return on the fair value of that property. The Commission doesn't have any valid legal basis to deny the Company that return based on the alleged statements attributed to Mr. Hill and GCSC. Any such decision by the Commission would violate Article 15, §§ 3 and 14, and Article 2, § 17, of the Arizona Constitution.

Finally, it is well-established Arizona law that the Commission is *not* a court of general jurisdiction and the Commission does not have authority to decide contractual and quasi-contractual disputes. Here, some GCSC customers ostensibly suggest that the Company has some sort of binding contractual or quasi-contractual obligation not to seek a rate increase at all for the expansion project. Other customers contend that GCSC agreed not to seek a rate increase for five years. The Commission does not have authority to decide those contractual and quasi-contractual issues in the pending rate case.

II. FACTUAL BACKGROUND.

By way of background, GCSC originally received its CC&N in Decision No. 56631 on September 14, 1989. In August 2001, Algonquin acquired the Company's stock from Shea Homes. The Commission approved GCSC's current sewer rates in Decision No. 64186 dated October 30, 2001. Those rates were based on a test year ending March 31, 2000 and the rates became effective on November 1, 2001. When Algonquin acquired GCSC in 2001, the GCSC sewer plant had substantial odor, noise and capacity problems. Under Algonquin's ownership, GCSC developed a plan to upgrade and expand the plant to resolve those problems. GCSC proposed to finance the renovation project with a combination of capital investment by the Company and hook-fees from developers and

new customers. *See* Exhibit A. GCSC intended to include such "paid-in-capital" in rate base in a subsequent rate case. *Id.*; ACC Decision No. 64186, Settlement Agreement, p. 3, ¶¶ 12-13.

A. <u>The Company's Renovation and Expansion of the Treatment Plant.</u>

Through paid-in-capital provided by Algonquin, GCSC has invested more than $16 million in improvements since 2001. *See* Weber DT at 4-5. The most significant improvement involved the recent renovation and expansion of GCSC's plant. *Id.* at p. 7. Those improvements were completed in August 2005 and they became operational on October 31, 2005. *Id.* The plant renovation and expansion project was necessary to (1) address odor and noise complaints from customers and neighboring property owners, (2) to refurbish and upgrade existing plant facilities to ensure continued and efficient performance, and (3) to add needed treatment capacity to meet customer needs. *Id.* at pp. 7-9; Hernandez RB at 2-5. The noise and odor problems with the plant existed before Algonquin acquired GCSC in 2001. Weber DT at 7-8. In acquiring GCSC, Algonquin committed to invest the capital necessary to solve the odor, noise and capacity problems.

If Algonquin hadn't acquired GCSC's stock in 2001, a renovation and expansion still would have been necessary. In that scenario, the prior management (Shea Homes) of GCSC, or another buyer, would have been forced to finance the project and include the costs in its rate base. Regardless of Mr. Hill's comments in 2002-2003, customers would have faced a rate increase to allow GCSC an opportunity to earn a return on the fair value of its plant following renovation and expansion. If the Commission were to reject GCSC's pending rate increase based on Mr. Hill's comments, customers would receive a substantial windfall at GCSC's expense.

As noted above, GCSC funded those upgrades through paid-in-capital and hook-up fees *after* the Commission issued its decision in the 2001 rate case. In the 2001 rate case, the Commission authorized GCSC to collect a hook-up fee of $900/customer for new

developments. *See* Decision No. 64186 at p. 6, Settlement Agreement, p. 2. GCSC used virtually all available funds collected from such hook-up fees to *partially* fund the plant renovation and expansion.[1] Weber DT at 7. Unfortunately, the hook-up fees were nowhere near sufficient to cover the total cost of the renovation, which is why GCSC used shareholder capital to fund the balance of the project. *Id.* Certainly the Company and Mr. Hill did not (and, in fact, could not) guarantee that new hook-ups would cover the entire $11.2 million renovation project.[2] It is unreasonable to suggest that GCSC would agree to fund millions of dollars of plant without seeking recovery of and a return on that investment.

B. Mr. Hill's Prior Statements.

In various comment letters filed in this docket, GCSC customers attribute a wide variety of prior statements to the Company and Mr. Hill.[3] Various newspaper articles also attribute various statements to Mr. Hill on behalf of GCSC. *See, e.g.,* July 14, 2006 East Valley Tribune article entitled "Sewer, management of plant raise stink for some in GCSC" ("But after Algonquin purchased the GCSC facility in 2001, then-Algonquin spokesman Trevor Hill promised residents their rates wouldn't increase. Despite the $10 million his company was forced to spend on improvements, Hill said the monthly rate would stay at $37"); March 18, 2006 Mesa Tribune article entitled "Bid to double sewer

[1] Upon completion of the renovation project, GCSC had $7,000 remaining in the hook-up fee account.

[2] As authorized by the Commission in Decision No. 64186, GCSC's hook-up fee for new sewer connections is $900 per customer. At $900/customer, the Company would need 12,444 new connections to fund the $11,200,000 plant expansion.

[3] *See, e.g.,* 8/16/06 Comments by S. Curry ("They promised that there would be no rate increase as a result of the modification"); 8/14/06 Comments by G. Volmer ("We were told as the area built out, there would be more home owners to the monthly costs would not have to be increased—in fact, it might even be less"); 8/11/06 Comments by J. Lazur ("this Community was promised by former management that there would no further increases after the 2003 increase..."); 8/4/06 Comments by J. Lickar ("they now want to renege on their promise not to raise the fees for 5 years"); 7/27/06 Comments by L. LaPrise ("Before the improvements were made Mr. Hill, a representative of the GCSC Sewer Company, publicly pledged that no rate increase would incurred for five years if the expansion project was approved").

charges upsets GCSC residents ("...Trevor Hill, who was president of Algonquin when it sought permission to expand in 2003, promised at public meetings and in newspaper interviews that the company wouldn't seek a rate increase for five years").

For obvious reasons, newspaper articles do not constitute substantial evidence. Any customer claims based on these statements attributed to Mr. Hill face substantial evidentiary problems. Neither this Commission nor a court can rely on such hearsay statements as credible evidence. The evidentiary problems aside, GCSC simply did not make a binding promise or guarantee not to increase sewer rates as a result of Company investments for plant renovation and expansion.

In 2002-2003, GCSC undertook an informational campaign—led by Mr. Hill—to advise customers of the need for the plant renovations and capacity additions and the impact it would have on customers. Mr. Hill assured customers that GCSC would fund the necessary improvements to solve the noise and odor problems, and he explained the Company's business plans for the project. He circulated a "Questions and Answers" page for the proposed "Plant Upgrade," which included the following question and answer:

> **Will the upgrade mean an increase in rates?**
>
> No. GCSC is committed to providing the upgrade through a combination of paid-in-capital and new development hook-ups.

See Exhibit A, p. 2. Apparently, many customers interpreted that statement as assurance that GCSC would not raise rates as a result of the project. That interpretation doesn't reflect a full understanding of utility ratemaking in Arizona.

Under the plain language of the handout, the Company "committed to provide the upgrade through a combination of paid-in-capital and new development hook-ups." In that handout, GCSC didn't waive its rights to seek a rate increase and it didn't promise that rates "would not increase again following Algonquin's purchase of the GCSC facility

in 2001 and the rate increase that also occurred in that year." *See* August 9, 2006 letter from Commissioner Mayes. To the contrary, by using the term "paid-in-capital," the Company clearly intended to include such capital costs in its rate base.

In the 2001 rate case, GCSC, ACC Staff and Mountainbrooke Village (intervenor) entered a Settlement Agreement dated August 29, 2001. In Decision No. 64186, the Commission approved that Agreement. In the 2001 Agreement, the Company agreed "that it will not seek an increase in its rates and charges for sewer utility services within 24 months of the issuance of an order approving this Agreement . . ." *See* Decision No. 64186, Settlement Agreement, p. 3, ¶ 12. The Company did *not* agree to forgo rate relief for future plant investment in renovations and expansion.[4] The 2001 Agreement further provides that "a Hook-Up Fee Tariff is appropriate to permit [GCSC] to recover ***a portion of the capital costs associated with plant additions needed to serve new customers***." *Id.* at ¶ 13 (emphasis added). Again, the Company clearly did not agree or represent that hook-up fees would be used to recover all capital costs associated with plant expansions. By indicating that hook-up fees would cover only a "portion of the capital costs" for plant expansion, the parties clearly understood that GCSC would finance the remainder with "paid-in-capital" and later seek recovery through rate base.

In 2002-2003, GCSC echoed those statements by telling customers in the written handout that the renovation and expansion would be financed with a combination of hook-up fees and "paid-in-capital" which means that the Company would include those capital costs in its rate base. For utilities, "paid-in-capital" is a term of art. Essentially, paid-in-capital is a "capital expenditure" made by a utility company for the acquisition or improvement of a utility asset used and necessary to provide utility service. In turn, utilities include "paid-in-capital" as part of "rate base" which is the "value of a water

[4] By limiting the rate case moratorium to 24 months, GCSC clearly intended to pursue a rate case after expiration of that 24-month period.

utility's property used in computing an authorized return." By contrast, "new development hook-ups" are treated as non-refundable contributions in aid of construction and are a deduction from rate base.

According to newspaper accounts and customer comments, Mr. Hill also stated in late 2002 or early 2003 that GCSC did not anticipate filing a rate case for five years. Due to substantial customers complaints about the long-standing odor and noise problems, Mr. Hill acknowledged that GCSC did not intend to seek a rate increase until *after* GCSC rectified the noise and odor problems. "Five years" was obviously an outside estimate of the time it would take to design, engineer, permit, entitle and construct the plant improvements.

GCSC essentially adhered to those statements by Mr. Hill. GCSC funded, permitted and constructed the plant renovations which became operational in October 2005. As of today, the plant is fully compliant with ADEQ and ACC regulations and inspections on the noise and odor issues. After the improvements became operational, GCSC filed its pending rate case on January 13, 2006—over 50 months after the 2001 rate case. Customers have expressed frustration that GCSC has "reneg[ed] on [its] promise not to raise the rates for five years." In response to those concerns, GCSC believes that Mr. Hill made the "five year" comments in the fall of 2002. Any rate increase resulting from this docket likely will not go into effect until 2007 or nearly five years since Mr. Hill's comments. It also bears emphasis that Mr. Hill's "five year" comment demonstrates that GCSC intended to seek a rate increase for the renovation project.

Finally, in 2002-2003, Mr. Hill estimated that the expansion project would cost $5-6 million (approximately $5-6 per gallon). In 2002-2003, the Phoenix area was experiencing unprecedented population growth and a residential home-building boom. When Mr. Hill made his prior comments, GCSC anticipated that such unprecedented growth would continue in GCSC's service area. Unfortunately, however, growth declined

in GCSC's service area as a result of a drop in the residential real estate market. Further, due to price increases, GCSC's actual cost for the renovation project was $11.2 million (or $12 per gallon). Obviously, GCSC is not to blame for those market factors.

II. PRIOR STATEMENTS BY GCSC IN 2003 HAVE NO BEARING ON THE COMPANY'S 2006 RATE CASE.

A. The Company's Prior Statements Are Not Legally Binding and Do Not Preclude The Company from Obtaining Rate Increases.

As a matter of Arizona law, the comments and statements attributed to GCSC in 2003 do not preclude the Company from obtaining rate increases. As discussed above, taken in proper context, Mr. Hill advised customers that the plant expansion and upgrades would not result in an immediate rate increase, but would be financed by "paid-in-capital" and hook-up fees. As alleged in customer comments and newspaper articles, Mr. Hill made additional comments that the Company's intent was not to seek a rate increase for five years. Those statements are a far cry from a binding legal promise not to seek a rate increase for an $11.2 million capital investment for necessary utility assets. *See Tennent v. Leary,* 82 Ariz. 67, 308 P.2d 693 (1957) (unilateral promise is not binding unless "an executed consideration (or cash) is exchanged for it"); *Gates v. Arizona Brewing Co.,* 54 Ariz. 266, 95 P.2d 49 (1939) ("Mutuality of obligation is an essential element of every enforceable agreement. Mutuality is absent when only one of the contracting parties is bound to perform. . ."). In its written handout, the Company only "committed to provide the upgrade through a combination of paid-in-capital and new development hook-ups." Put another way, GCSC told customers that the upgrades would be financed as "paid-in-capital" which means that the Company would include those costs in its rate base.

Further, the prior statements attributed to the Company are not legally binding against GCSC for lack of consideration. *See, e.g., Jaramillo v. Champagne Pools of Arizona, Inc.*, 125 Ariz. 398, 609 P.2d 1098 (App. 1980). Those statements were not made as part of a binding agreement with customers. Instead, Mr. Hill advised customers

of GCSC's business plans in relation to the expansion project. Such unilateral statement of intent is not legally binding against GCSC. *See Johnson Intern., Inc. v. City of Phoenix*, 192 Ariz. 466, 967 P.2d 607 (App. 1998).

Regardless of whether those statements were legally binding, GCSC adhered to the substance of Mr. Hill's 2002-2003 statements. GCSC funded, permitted and constructed the plant renovations which became operational in October 2005. As of today, GCSC has solved the plant's noise and odor problems. After the improvements became operational, GCSC filed its pending rate case on January 13, 2006, over 50 months after the Commission's decision in the 2001 rate case, and any resulting rate increases will not go into effect until nearly five years after Mr. Hill's comments in 2002.

B. The Company's Prior Statements Are Not Relevant to the Determination of Fair Value.

In its rate application, GCSC seeks an order establishing the fair value of its property used in providing utility service and, based on such finding, GCSC seeks permanent rates and charges designed to produce a fair return on such fair value. By law, the prior comments attributable to GCSC are not relevant to the Commission's consideration of the pending rate case. In the rate case, the Commission must determine "fair value" of the Company's utility assets and use it in setting rates. *See, e.g., Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 155, 294 P.2d 378 (1956).

Under these cases, the prior comments attributable to GCSC have no bearing on the Commission's determination of "fair value" of GCSC's utility assets or its determination of utility rates. The prior statements do *not* change the fact that GCSC incurred capital expenditures on plant used and useful in providing utility service to customers. If the Commission were to deny or reject GCSC's rate application based on the prior statements attributed to Mr. Hill, then the Commission would violate the Arizona Constitution by denying the Company a just and reasonable rate of return on plant used and useful in

providing utility service. *See* Ariz. Const. Art. 15, §§ 3 and 14. Further, such action by the Commission would constitute an unlawful taking of private property under Article 2, § 17 of the Arizona Constitution.

C. The Company's Alleged Prior Statements Do Not Preclude Rate Increases Under Any Legal Theory of Arizona Law.

The statements attributed to GCSC cannot be used to prevent the Company from seeking a rate increase under any legal theory in Arizona. The legal doctrines of waiver and/or promissory estoppel simply don't apply. GCSC didn't intentionally relinquish its rights to seek a rate increase. *See, e.g., Morganteen v. Cowboy Adventures, Inc.*, 190 Ariz. 463, 949 P.2d 552 (App. 1997)("An actual bargain must be made" to establish an 'intentional relinquishment' of a known right" for waiver purposes). In fact, Mr. Hill's statements in 2002 that GCSC would not seek a rate increase for "five years" demonstrates that GCSC intended to seek a rate increase for the renovation project.

Nor can the necessary elements for promissory estoppel be satisfied under Arizona law. In Arizona, "a promise which the promisor should reasonably expect to induce action or forbearance on the part of the promise or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." *Double AA Builders, Ltd. v. Grand State Construction, LLC.*, 210 Ariz. 503, 114 P.3d 835 (App. 2005). Here, the Company's statements didn't induce action or forbearance by any customers, and customers did not detrimentally rely on such promises by GCSC. Enforcement of the statements also is not necessary to avoid injustice—the plant renovation and expansion were reasonable and necessary for the benefit of the ratepayers and would have occurred under the prior owner of GCSC.

Under these circumstances, the prior Company statements simply do not give rise to a claim of promissory estoppel against GCSC. *See, e.g., Cassidy v. Old Lycoming Township*, 1974 WL 15857 (Pa. Com. Pl. 1974) (letter from Town stating that, in the

event of construction of a new sewer system, customers already being served by another sewer provider would continue to be charged existing rates does not estop Town from enacting a subsequent ordinance increasing rates); *Jamison v. Consolidated Utilities, Inc.*, 576 P.2d 97 (Alaska 1978)(utility not estopped from denying validity of contract based on prior statements before Public Utilities Commission); *Montana Power Co. v. Public Service Comm'n*, 692 P.2d 432 (Montana 1984)("Without a clear and unambiguous promise, the doctrine of promissory estoppel does not apply"). Also, any representation made to the party claiming estoppel "must have been based upon full knowledge of the facts." *Donaldson v. LeNore*, 112 Ariz. 199, 540 P.2d 671 (1975). Here, Mr. Hill did not have full knowledge of all pertinent facts when he made his statements in 2002-2003. Specifically, he didn't know exactly how much of the costs for the project would be covered by hook-up fees; and he didn't know how much the project would cost. As such, the doctrines of promissory or equitable estoppel simply do not apply to the Mr. Hill's prior statements.

D. The Commission Has No Authority or Jurisdiction To Resolve Customer Claims Based on the Alleged Prior Statements of the Company.

Even assuming *arguendo* that the prior statements by Mr. Hill give rise to a valid legal claim, the Commission has no jurisdiction or authority to adjudicate that claim.[5] Under Arizona law, the Commission is not a court of general jurisdiction and the Commission does not have authority to decide contractual and quasi-contractual disputes. For instance, in *Trico Electric Cooperative v. Ralston*, 67 Ariz. 358, 196 P.2d 470 (1948), the court held that "no judicial power is vested in or can be exercised by the corporation commission unless that power is expressly granted by the constitution. None of the

[5] By submitting this brief, GCSC does not concede that the Commission has authority or jurisdiction to address the legal merits of customer claims based on the prior comments attributed to the Company. Rather, the Company expressly contends that the Commission does ***not*** have authority or jurisdiction to decide those contract and quasi-contractual issues and GCSC provides this legal brief to the Commission solely in response to Commissioner Mayes' August 9 letter.

constitutional provisions set forth above confer upon the commission the jurisdiction to pass upon the construction and validity of contracts." *See also General Cable Corp. v. Citizens Utilities Co.*, 27 Ariz. App. 381, 555 P.2d 350 (1976)("We agree with the trial court that the construction and interpretation to be given to legal rights under a contract reside solely with the Courts and not the Corporation Commission").

Here, Commissioner Mayes has expressed concern because some of the Company's customers are claiming that the Company entered into some sort of binding contractual or quasi-contractual obligation not to seek a rate increase. To the extent the Commission issues a decision raising rates, ratepayers may pursue those claims in Superior Court—not the Corporation Commission. In the rate case, the Commission does not have any authority or jurisdiction to decide disputes between the Company and customers based on claims of breach of contract, waiver and/or promissory estoppel.

III. CONCLUSION.

For these reasons, the prior statements attributed to Mr. Hill and GCSC should have no bearing on the Company's pending rate case. If the Commission were to deny a return on the fair value of the Company's plant because of those prior comments, the Commission would exceed its jurisdiction and violate the Arizona Constitution by denying GCSC a just and reasonable rate of return on plant used and useful in providing utility service.

RESPECTFULLY SUBMITTED this 13th day of September, 2006.

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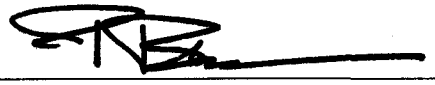
By 

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